BEFORE THE ARIZONA CORPORATION COMMISSION

WILLIAM A. MUNDELL
Chairman
JIM IRVIN
Commissioner
MARC SPITZER
Commissioner

IN THE MATTER OF THE GENERIC PROCEEDINGS CONCERNING ELECTRIC RESTRUCTURING.	DOCKET NO. E-00000-02-0051
IN THE MATTER OF ARIZONA PUBLIC SERVICE COMPANY'S REQUEST FOR VARIANCE OF CERTAIN REQUIREMENTS OF A.A.C. R14-2-1606	DOCKET NO. E-01345-01-0822
IN THE MATTER OF THE GENERIC PROCEEDINGS CONCERNING THE ARIZONA INDEPENDENT SCHEDULING ADMINISTRATOR.	DOCKET NO. E-00000A-01-0630
IN THE MATTER OF TUCSON ELECTRIC POWER COMPANY'S APPLICATION FOR A VARIANCE OF CERTAIN ELECTRIC COMPETITION RULES COMPLIANCE DATES	DOCKET NO. E-01933A-02-0069
IN THE MATTER OF THE APPLICATION OF TUCSON ELECTRIC POWER COMPANY FOR APPROVAL OF ITS STRANDED COST RECOVERY	DOCKET NO. E-01933A-98-0471

HARQUAHALA GENERATING COMPANY'S COMMENTS TO UTILITY DIVISION STAFF'S TOPICS

Harquahala Generating Company, LLC ("HGC"), by and through its attorneys, hereby provides Staff with comments on item #4 of the Utility Division Staff's ("Staff") topics listed in Staff's May 13, 2002 Request for A Procedural Order. HGC asked Mr. Alan Taylor, President of

Sedway Consulting, Inc. and a nationally-recognized expert competitive bidding for wholesale electric power, to address item #4. The following is his response:

RESPONSE OF ALAN S. TAYLOR TO STAFF ITEM #4

4. Description of the Various Types of Competitive Solicitations and their Attributes.

Power supplies that are acquired through competitive bidding processes are usually obtained through one of two methods:

1. solicitation through a request for proposals (RFP), and
2. participation in a formalized auction.

A solicitation process is initiated with the issuance of an RFP that specifies needs that the buyer seeks to fill. In some solicitations, a pre-bid conference is held so that interested suppliers can ask questions and gain additional insights into the buyer's needs. Once the buyer receives responses to the RFP, an evaluation process is undertaken. This may involve utility system simulation modeling or other analytic procedures to determine the best proposed power supply contract(s). The buyer then selects a short list of top bidders with whom to commence negotiations. Usually, this short list includes more supply than the buyer is seeking – thereby providing some maneuvering room if negotiations with one or more of the suppliers prove unsuccessful.

An auction process entails a centralized, more automated approach to selecting power providers. Frequently, power supply auctions are conducted electronically on the Internet. Most such auctions to date have been part of short-term selection processes (e.g., day-ahead or hour-ahead procurement decisions by power exchanges). One exception involves a power supply auction that was recently conducted in New Jersey, whereby suppliers were selected to supply 12 month's of basic generation service for the state's electric distribution companies.

Advantages and Disadvantages

The two different competitive power approaches have various advantages and disadvantages. For example, the RFP-based solicitation process is more readily customized to meet specific buyer needs or address specific regional constraints. Also, it is faster to develop and less expensive to conduct for a single solicitation. However, the evaluation, selection, and negotiation process is usually more time-consuming.

The auction process, on the other hand, involves more up-front development (resulting in a greater investment of time and money) but is faster to conduct – once the process has been set up. It is ideally suited for instances where power transactions are going to be solicited and evaluated repeatedly (e.g., in scheduling daily supplies in power pools or power exchanges). Thus, the up-front investment pays off in streamlining multiple evaluation and selection processes. Consequently, the product that is the subject of the auction must be standardized so that all offers can be quickly compared on a common metric. Assuming that all bidders have passed specific prequalifying requirements and have posted the necessary financial deposits, all participants are considered equal – except for a single price (or product quantity) that represents their complete bid and serves as the sole differentiating attribute of their proposals.

Recommendation

Given the circumstances faced by the Arizona Corporation Commission and Arizona's utilities, the RFP-based solicitation process probably makes most sense. The selection of the best resources to serve Arizona's electric customers over the next several years will require careful consideration of regional transmission constraints, new transmission projects that are likely to relieve some or all of those constraints within certain time-frames, and the specific ancillary services that must be acquired to operate the state's electric system reliably.

In New Jersey, the recent auction was successful in no small part because of the strongly interconnected transmission system and tight power pool operations of the Pennsylvania-Jersey-

Maryland Independent System Operator (PJM ISO). Although transmission bottlenecks can occur in this power pool, there is sufficient generation on either side of these bottlenecks to address such congestion through redispatching. Also, there are well-developed rules and markets for ancillary services. The New Jersey auction sought "slices-of-system," whereby suppliers assumed responsibility for providing all capacity, energy, transmission services, and ancillary services for a set percentage of an electric distribution company's loads in each and every hour. This was only possible because of the well-developed scheduling, operating, and settlement procedures of the PJM ISO.

Also, the deregulation policies that were developed for the New Jersey electricity market had sufficiently addressed market power concerns and minimized the possibility for price manipulation in the auction. First, most of the New Jersey utilities completely divested their generation over the last several years – selling it to numerous non-affiliated generation companies. Second, the PJM market is accessible to many generation companies throughout the northeast. Thus, no one generation company has a dominant position in the regional market.

It may be possible for Arizona to adopt a "slice-of-system" auction-based power procurement process, but not until an independent regional transmission operator (RTO) or ISO similar to PJM has been established in the region and sufficient diversity of generation ownership has been achieved to address market power concerns. Until then, an RFP-based solicitation approach holds the best promise for unlocking the benefits of a competitive wholesale market for Arizona's electric customers. In such a process, suppliers can offer whatever services they can best provide (e.g., baseload energy, intermediate generation, peaking services, ancillary services). Assuming that the buyer's minimum system requirements are well-defined, the evaluation team can determine the best, lowest-cost/lowest-risk portfolio of resources that meet those requirements. Those requirements should be specified in the RFP and should include the amount

of peak system capacity and the amount of each relevant category of ancillary services that the buyer seeks.

Lastly, an RFP-based solicitation is usually undertaken to entertain offers with terms of more than a year. In fact, a final portfolio of contracts may include a mixture of 1-year, 3-year, 5-year, and 10-year contracts. Such a blend is likely to provide the necessary flexibility for reformulating Arizona electric customers' power supplies over the rest of this decade.

THE FOREGOING COMMENTS OF ALAN S. TAYLOR ARE RESPECTFULLY SUBMITTED this 21st day of May, 2002, by the undersigned on behalf of Harquahala Generating Company, LLC.

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By Sarah Penne